

Commercial Aviation Events Air Cargo Industry
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CARGO AIRLINE STARTUP

What are the Financing Options, pitfalls and Challenges to be faced

Good Morning:

Thank you for coming in this morning. It means a lot to me that all of you are here today. For those of you who made an extra special effort to make it to this conference in response to my invitation, a special thanks to you.

We meet today in an age of tremendous opportunity. America has enjoyed the longest post-war economic expansion in its history, creating many new fortunes and millions of new jobs. Many parts of the world have shared in this prosperity. Trade between nations is exploding as traditional trade and tariff barriers drop and governments realize the benefits of international trade.

In spite of the current business slowdown, the long-term outlook for world GDP growth is excellent.

It is in this dynamic environment that we at AMERICAN FRIENDSHIP present to you our proposal to launch a new cargo airline.

The American Friendship Philosophy

American Friendship is our way of building relationships and friendships with the rest of the world.

Most cargo airlines are in the ‘airport to airport’ transportation business.

American Friendship is also in the ‘World Trade’ business

PERSONAL COMMITMENT & FINANCIAL DISCIPLINE

No truly great organization, especially an airline seeking world status like AMERICAN FRIENDSHIP can succeed without financial discipline and personal sacrifice by its founders.

Starting an airline involves getting key people”

- *“Interested in your ideas” and*
- *“ Committed to your success”.*

This requires frequent travel around the country and all over the world, listening to key people and gaining their confidence. It requires funds. With no initial institutional backing, it requires the founder to commit his personal resources. And. I can assure you that there are innumerable sacrifices and many difficult personal choices to be made when allocating these limited resources.

CARGO AIRLINE STARTUP

What are the financing options and challenges to be faced

WHY A NEW AIRLINE?

WORLD AIR CARGO FORECAST

The general consensus is that there are two great reasons for long-term optimism about the future of air cargo, despite current market conditions. They are:

-World GDP growth, which is the engine of this air cargo boom, will average 3% per year through 2019.

-Air cargo will grow annually at a healthy clip of 6.4% as a result.

IMPLICATIONS FOR FLEET PLANNERS

What all of this means is that during the next 20 years the freighter fleet is expected to double. In numerical terms, we will need 2,600 freighter airplanes by 2019 as nearly 1,100 retire.

1,500 “additional” freighters will be required.

The greatest growth will occur among wide body freighters, which will ultimately represent nearly 60% of the fleet and more than 90% of total freighter capacity.

WIDEBODY ACMI SERVICES

The competitive nature of the air cargo industry requires innovation and flexibility.

Wide- body ACMI services, which provide carriers with this flexibility, are one of the fastest growing sectors of the air cargo market, increasing 21% per year since 1990. In 1999, these ACMI operators carried 9% of world traffic.

This is the market in which AMERICAN FRIENDSHIP intends to be in. As an ACMI operation we will provide traditional airlines with a “flexible option” to contract for air transportation services.

If your demand for capacity is uncertain or highly seasonal, or if you are reluctant to invest in expensive wide body capacity, we will augment your existing services with additional lift. . Thus, you require no major investment in dedicated equipment.

There are several outstanding examples of highly profitable airlines that have succeeded using this model, chief among which is ATLAS AIR.

We intend to be the first new major cargo airline of the millennium.

ATLAS AIR’s “BUSINESS SUCCESS MODEL”FOR ACMI OPERATION

According to this leading wide body aircraft wet lessor, a successful ACMI operation has the following characteristics:

- Provision of “airport to airport” transportation services*
- Dedicated aircraft for each customer*
- ACMI contracts for durations of 3-5 years*
- Customer guarantees of revenues of between 12-14 hours of flying time per day.*
- Fixed rates per hour (with some escalation clauses)*
- Take or pay contracts*
- Contract rates typically 30-45% below customer’s own cost.*
- Contracting only with investment grade credits as customers.*
- Avoiding the airline industry’s four most volatile risks:*
 - a) FUEL(Customer pay for fuel costs)*
 - b) YIELD(Fixed rate 3-5 year contracts with blue chip customers)*
 - c) LOAD FACTOR(Customer is responsible for filling aircraft)*
 - d) CURRENCY(All contracts priced in US Dollars)*

However, as we grow our business, we will develop our own individual style and unique customer relationships.

DEMAND

All it takes is one major world-class airline to commit to a 3-5 year contract with us to launch AMERICAN FRIENDSHIP. We are confident that we can start building our fleet, putting together a management team and obtain our financing based on this first contract.

We anticipate demand for our services from the many scheduled carriers worldwide who would like to offer new freighter services, but cannot or will not do so, due to the large capital investment and long-term ownership involved. At the present time, there are at least 40 airlines that can be actively solicited for ACMI contracts.

Another benefit to such carriers is that our aircraft need not be compatible with their fleet, as we will provide crews and maintenance.

AMERICAN FRIENDSHIP is in contact with several scheduled world-class carriers regarding potential ACMI contracts. Even today, we are confident that strong demand exists for our services.

*However, having said this let me point out, that **we are very keen to start our business as soon as possible.***

AIRCRAFT CHOICE

American Friendship is in the "world trade business", requiring a 'World Aircraft'. In our opinion the Boeing 747 Freighter is an ideal choice for our global strategy, which will include connections to the booming Asian market from North America.

We decided not to pursue the DC10/MD-11 option because that would put us in direct competition with integrators like Fed Ex for sourcing the few remaining aircraft.

We thus have narrowed our choice to two B747 variants:

- *New or late model B747-400 production freighters*
- *Selective, well maintained, production or converted B747200s.*

Our challenge as a new airline will be to operate an aircraft that is reliable, economical and environmentally friendly.

FINANCING AND OPERATING A B747-400F:

This is the ideal scenario for us. The benefits of operating a fleet of newer 747-400 freighters include better fuel efficiency, smaller flight crews and lower maintenance costs. These will have to be weighed against the higher finance or lease costs. Clearly high utilization is key to the economics of this aircraft.

Will our financial backers allow us to adopt this scenario? If not, we will work with our second scenario.

FINANCING AND OPERATING A B747-200 for conversion to a freighter:

As you may be aware, there are several risks to be considered in buying and operating used B747-200s. This aircraft has been used primarily by major airlines for passengers first, followed by freight operators.

Chief among these risks is the fact that used passenger B747-200s have very low residual values, since the number of surplus aircraft exceeds the number being converted to freighters.

The market values of used B747-200s are basically the sum total of the values of their engines.

If we opt for B747-200 aircraft, we will only consider aircraft with MTOW (maximum take-off weight) in excess of 800,000 lbs, at Stage 3 noise rules, and with JT9D-7J or later variants CF6 engines.

We will scrutinize the vintage and maintenance records of every engine.

We will solicit the best professional advice from engine maintenance providers and asset managers towards this objective.

In short, we will institute a “world class maintenance program” for all our aircraft, new or old:

ACQUISITION/BUILD COST ASSUMPTIONS:(400F vs. 200F)

A) B747-400F's(Production Freighters)

List Price: \$177 million to \$195 million

Typical prices paid by airlines: \$125 million to \$160 million

B) B747-200SF's (Converted passenger/combi with high gross weight)

Total build cost range: \$35 million to \$40 million

THE B747-400F'S PRICE TAG IS ALMOST FOUR TIMES HIGHER THAN THAT OF THE B747-200SF.

A VERY HIGH UTILIZATION RATE IS KEY TO THE ECONOMICS OF OPERATING A FLEET OF B747-400F'S.

Other considerations include the B747-400F's fuel efficiency, smaller flight crew, lower maintenance costs, higher payloads and longer stage lengths.

How we finance a sample investment of this magnitude is our biggest challenge.

CHALLENGES OF FINANCING A STARTUP CARGO AIRLINE

Start-up airlines such as AMERICAN FRIENDSHIP will face three major hurdles in obtaining financing:

- a) First, “traditional minded” investors will hesitate to invest in a startup operation.*
- b) In case an “airline startup” does get funded, it is highly probable that this fund base will be extremely small, making the project highly “under capitalized”. This exposes the startup to a major financial risk in case of any adverse situation.*
- c) The perceived “residual value risk” of investing in freighters converted from older aircraft will discourage “traditional financiers” with “limited exposure” to the freighter business. Most of these “asset based” financiers will continue to invest in newer aircraft, because it is much easier to re-market them.*
- d) Most Operating Lessors are not ‘fully prepared’ for the global air cargo market*

Established airlines with higher credit ratings are able to use financing techniques such as straight cash purchase, borrowing of debt, sale and lease back transactions, finance leases, private investments and operating leases.

Most startup airlines such as AMERICAN FRIENDSHIP may find that all of these avenues of financing have been rejected, except for the operating lease.

WHAT WILL IT TAKE TO FINANCE A STARTUP LIKE AMERICAN FRIENDSHIP?

AMERICAN FRIENDSHIP is looking to partner with three distinct types of financiers:

- A) PRIVATE EQUITY INVESTORS:** These are the individuals or organizations who will provide the initial seed capital to fund the numerous “startup expenses” of AMERICAN FRIENDSHIP on a strictly RETURN ON INVESTMENT basis.*
- B) STRATEGIC EQUITY PARTNERS:** These will include suppliers who have an interest in the success of our operation since it will eventually mean more business for them. They can also include potential airline clients who would like us to succeed since it assures them of a “preferential supply” of wide-body freighter capacity, without a major capital investment.*
- C) OPERATING LESSORS:** These are the financial organizations, which will take the risk of acquiring, converting, and then leasing used B747-200 aircraft with their name behind it.*

We will seek to initially dry-lease three converted Boeing 747-200Fs for our ACMI Operation.

Our private equity partners will be seeking high returns on investment and a sound ‘exit’ strategy. We intend to provide them with both. We ask that you, our private equity partners allow us to become the best financed “cargo airline startup” in the industry.

Our “strategic” equity partners are looking to build profitable, long-term relationships with us. We will do our utmost to make this possible. We ask for their help, experience and technology to become a truly world-class operation.

Our operating lessors are seeking a stable and guaranteed stream of lease-payments through the life of their lease, combined with top-level –management of there leased

assets. It is our intention to be the best paymasters, and the best asset managers. We ask that they give us their “best assets”, and we will maintain them like our own, and try to become their long-term customers.

To all our financiers let me say this. When we ask for your financial support, we intend to provide you with:

- Prudent planning and realistic financial projections about our business.*
- An objective look at our maintenance cost scenario, including the possibility of earlier than scheduled maintenance.*
- A realistic “best case” and “worst case” scenario to account for both good times and bad.*
- A “world class” team of professionals to run AMERICAN FRIENDSHIP.*

It is my sincere hope that conferences such as this, will increase the financial community’s understanding of the immense opportunities in the cargo business, encouraging more operating lessors to cross the line, and make major investments in wide body aircraft acquisition and modifications.

CONCLUSION

In conclusion, let me say this:

Persevering with a project of this size has demanded a commitment of “gigantic” proportions. Not many people in this world have expressed an interest in starting an airline, and the challenges to a new entrant are formidable. However, I am convinced that we have made the right decision. This journey has been a deeply satisfying experience for me.

I have no doubt in my mind, that with your help, we will succeed.